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Features

Realty: A national market

'Big picture' is needed for overall investment strategies

By Clayton P. Pritchett

FOR YEARS, real estate practitioners have extolled the local market significance of real estate and have minimized the existence of a national market. However, this understanding is changing rapidly.

The huge new pools of investment capital representing domestic and foreign pension funds and private investors are developing national investment strategies and need information to help in their planning.

These sophisticated investment managers are used to dealing with national and even international markets in stocks and bonds.

They are also used to the monitoring of investment results through widely reported daily transactions in the New York and various regional stock exchanges.

Similarly, these investment managers in planning real estate investment strategies are constantly seeking more accurate information on the cyclical characteristics of the supply and demand for office, industrial and retail properties.

Insights into the magnitude, timing and regional variation of various forms of real estate were gained by a recent analysis.

The study looked at investment-grade real estate which has a replacement cost slightly in excess of $4 million. Replacement cost includes hard and soft construction costs and a developer's profit. Also, industrial properties are assumed to be groups of several buildings.

The collection and analysis of construction activity was greatly aided by computerization, accumulating information in both millions of square feet and dollars.

Because most real estate practitioners like to have data by small areas, breakdowns were included for selected regions and metropolitan areas.

Using this data, supply and demand cycles could be identified.

The chart on this page plots the additions to the supply of investment-grade real estate in billions of dollars during the 16-year period from 1967 to 1982.

Across the bottom of the chart is the year during which the construction was started. Along the left-hand margin is the 1982 replacement cost, which is defined as the square footage area constructed in each of the 16 years multiplied by the average cost of development experienced in the first half of 1982.

The figures plotted are based on data supplied by Data Resources Inc., and represent the cost of replacing these properties in late 1982.

The replacement-cost chart shows the dominance of office properties in investment-grade real estate.

In most years, office development exceeded the sum of both industrial and retail development, particularly during the past 2½ years when office construction exploded. Industrial properties consist essentially of warehousing/distribution buildings and exclude manufacturing facilities.

In every year, the amount of retail development exceeded the amount of industrial development.

However, retail development, which was extremely popular during the late 1960s through the early 1970s, is on a long-term downward trend.

In contrast, industrial development, which was of modest proportions through the early 1970s, recovered well in the late 1970s and is on a long-term upswing.

The one constant of all three types of investment-grade real estate is that each experienced a lull in construction activity during the mid-1970s.

The period since then, which represents construction starts between 1977 and 1982 and construction activity between 1978 and 1982, were recovery years.

Take note that the different forms of real estate reached their peaks in different years. Office construction starts reached a peak during 1969 and recently peaked in 1981. Retail construction starts reached their peak between 1972 and 1973, and then again in 1979. Industrial construction starts reached their initial peak in 1973 and 1974 and again during 1979.

This chart indicates office buildings have experienced a 10- to 11-year development cycle compared with a six- or seven-year cycle for industrial and retail construction.

Time will tell whether this disparity will continue in the future.

The composite total of investment-grade real estate construction starts rose to a level of more than $16 billion a year from the period 1969 to 1973, dropped to $8 billion in 1976 and peaked at $25 billion during 1981 before dropping below $20 billion again in 1982.

Keep in mind that the total construction of all office, industrial and retail buildings actually exceeds these levels because the figures do not include properties with replacement costs less than $4 million.

For this article, the development value of investment-grade real estate by real estate type as well as major region of the country was aggregated.

The table below shows the replacement cost of investment-grade real estate in billions of dollars by type and region for the years 1967-1982.

These data indicate that of the $240 billion worth of investment-grade real estate developed in the past 15 years, nearly 60% is represented by office buildings, more than 25% by retail and nearly 13% by industrial properties.

Geographically, nearly half has been built in the established areas of the Northeast and North Central United States and slightly more than half in the South and West.

Even though the Northeast formerly led in overall office construction, the South has maintained its dominance in overall industrial and retail development since 1967 and office construction since 1971.

The clearest indicator of the phase the real estate cycle is in is vacancy rates. The most recent market cycle 1975 through 1982 shows how vacancy rates identify various parts of the cycle.

During 1975-1976, at the bottom of the cycle, vacancy rates for offices peaked at between 10% and 15%. In the rising phase, 1977 through 1980-1981, office vacancies gradually declined from 10% to a more stabilized level of 5% to 6%.

At the top of the cycle, 1981 and 1982, vacancy rates were stable to gradually rising toward 6% or 7%, due to heavy construction activity.

In the declining phase, 1982 into 1983, vacancies are expected to climb again to levels between 10% and 15%.

Once the various phases of the real estate cycle for office, industrial and retail properties are more widely recognized, then investors have to realize what adjustments could be made in their investment strategies at various stages.

The case can be made for the use of a national monitoring service for investment-grade real estate to assist in the identification of phases of the cycle being experienced by each type of real estate.

As is the case with Wall Street, many times a real estate investor is uncertain whether a false or real bottom/resurgence is occurring. Investment groups should not rely upon national monitoring services to choose and select specific investment properties.

However, national monitoring services can provide a sound basis of knowledge for investment groups to understand more accurately the real estate cycle at the point prior to establishing annual refinements to their investment policy guidelines. ■

Clayton P. Pritchett is senior vice president for Landauer Associates, New York.

Profit-sharing profits . . .

Continued from preceding page

vested in their own company stock. These companies normally provide for distributing employer stock "in kind" to retiring participants at their request. Retirees have the option to hold the stock until the market for them turns favorable. Retirees decide when and how much to sell. They receive dividends up until this time and pay no taxes on unrealized capital gains until the stock is actually sold. Fully funded, rapidly vested, individual account profit-sharing plans, with no past service liabilities, do not put a burden on Social Security, but rather greatly buttress the system.

The investment risk is carried by participants under a defined contribution plan, by the company under a defined benefit program. True enough.

Profit-sharing participants, however, also share in investment gains. They bear risk with an opportunity to gain. They participate more fully in the risk/reward system. Poor investment decisions through the years can leave the profit-sharing participant impoverished in retirement but the odds are with him.

Profit Sharing Research Foundation's major study of "Profit Sharing in 38 Large Companies" provided an opportunity to evaluate profit-sharing benefits that actually were paid out to long-service, non-management employees. Overall, only six companies out of the 33 that provided this data, or 18%, generated profit-sharing benefits that fell below the pension standard.

Twenty-seven out of the 33 companies, or 82%, have profit-sharing programs that have generated benefits from 102% to 1,011% of the pension standard.

Not all profit-sharing participants end up as well, but the opportunity is there. ■

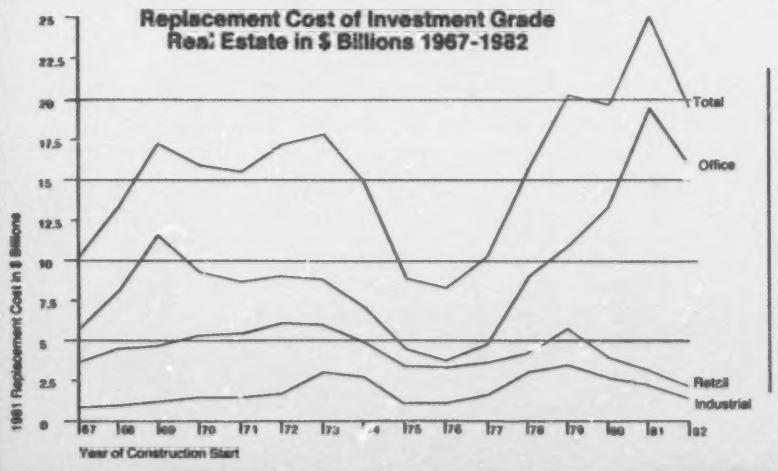

Table 1

Replacement Cost of Investment Grade Real Estate in $ Billions 1967-1982 By Type and Region

REGION	OFFICE	INDUSTRIAL	RETAIL	I.G.R.E TOTAL	%
Northeast	40.8 (29%)	4.6 (15%)	14.6 (22%)	60	24.9
North Central	26.8 (19%)	7.0 (23%)	17.9 (26%)	51.7	21.5
South	41.8 (29%)	11.4 (37%)	23 (34%)	76.2	31.7
West	32.6 (23%)	7.5 (25%)	12.5 (18%)	52.6	21.9
U.S. Total	142	30.5	68	240.5	100
% of Total	59	12.7	28.3	100	

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Market trips up real estate managers

By Steve Hemmerick

LOS ANGELES—A shakeout might be coming in the real estate adviser industry.

Real estate investment advisers sprang up by the dozens in the past 18 months to help pension funds invest in real estate and to earn healthy fees for themselves.

But to the surprise of many of them, few got the amount of pension money they expected.

Blake Eagle, who tracks 125 real estate investment organizations for clients of the consulting firm Frank Russell Co., estimates "no more than 10" of those advisers got large amounts of pension money in 1982.

Many real estate investment organizations sprang from financial service companies, including investment bankers, banks, insurance companies and brokerage services, that heard in 1981 about the coming "great leap" into real estate by pension funds. Many of them "ran into a brick wall," one consultant said.

Now some of those companies reportedly have put real estate marketing on a back burner, moving their salesmen to other projects. Some financial experts say the result will be a continuing shakeout in the industry, with many advisers quietly limping back to their primary forms of business.

According to the experts, many of the new advisers opened for business just as inflation began to cool, hurting some marketing efforts to sell real estate as an inflation hedge.

Then the economy cooled, leaving corporations strapped for cash and seeking ways to cut pension contributions, hurting the advisers further because real estate investments usually come out of new cash flow.

At the same time, plan sponsors were locking up high interest rates paid on guaranteed investment contracts and bonds with whatever cash they had. When the sponsors began to believe the stock market would rise, many found the stock

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Pensions & Investment Age

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SEC, DOL study incentive fees

Proposals by two agencies would permit performance-based fees

By Joel Chernoff

WASHINGTON—The Securities and Exchange Commission and the Department of Labor are working on separate proposals that together would allow pension fund managers to be paid on the basis of performance.

The SEC staff expects to present its recommendations to the commission within a month; the Labor Department hopes to publish its proposal sometime in June.

Relief granted by the SEC alone might not help pension fund managers, since they still would have to meet rules under the Employee Retirement Income Security Act.

Conversely, relief that is being contemplated by the Department of Labor would not aid registered investment advisers unless the SEC proceeds with its proposal.

The Labor Department's proposal stems from the work it has done on the definition of plan assets (*Pensions & Investment Age*, May 2).

The definition would introduce fiduciary status to a number of investment advisers who previously had not been considered fiduciaries. That would cause those advisers to become subject to tough guidelines regarding self-dealing. In-

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Late news

Revision proposed

WASHINGTON—Sen. Don Nickles, R-Okla., has introduced a bill that would revise the single-employer plan termination insurance provisions of ERISA. The bill would close up loopholes that allow plan sponsors to dump underfunded plans on the Pension Benefit Guaranty Corp. by terminating them or spinning them off. It also would give the PBGC a lien on company assets when a firm is granted a funding waiver. Sen. Nickles also urged that Congress increase the annual premium for single-employer plans to $6 per participant.

DOL sues Simmons

PEORIA, Ill.—The Department of Labor has charged businessman Harold Simmons and seven other pension plan trustees with manipulating employee benefit assets from eight pension plans to control other companies.

The department said Mr. Simmons misused $25 million in pension assets when pension funds of which he was trustee acquired interests in Amalgamated Sugar Co., Ogden, Utah; Keystone; Interpace Co., Parsippany, N.J.; and Cyclops Corp., Pittsburgh.

All of the pension funds are sponsored by companies controlled by Contran Corp., its affiliates and Mr. Simmons.

Dallas-based Contran is largely owned by a trust controlled by Mr. Simmons.

Mr. Simmons recently was sued by Cyclops Corp., which charged him with violating securities laws

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Valued at $54 million

Exxon contributes realty at pension fund's request

By Nancy Webman

NEW YORK—Exxon Corp., in a transaction initiated by its pension fund, has contributed about $54 million in real estate to its U.S. Dollar Annuity Fund as part of its 1982 contribution.

It is becoming increasingly common for companies to place stocks, bonds, real estate and even oil and gas royalties in their pension funds in lieu of cash contributions. However, the contributions rarely are made at the suggestion of the fund, but rather as a cash-saving device for the company.

H.L. Cone, manager-investment and plans financing for Exxon, said the pension fund was "independently out looking for real estate in Texas and the Southwest" when fund officials learned Exxon was "going to start selling some of their properties. When we heard, we said we'd like to take a look at some of them if it wouldn't be too much of a hassle." The result was the contribution of a 15.1-acre office and retail development in Houston's North Belt area, a successful commercial area near Houston's Intercontinental Airport.

Exxon made the contribution in December, but news of the transaction did not surface until after the company received an exemption last month from the U.S. Department of Labor as a prohibited transaction.

The property, part of the Greenspoint area in the North Belt, was given to the fund by Exxon U.S.A., a wholly owned subsidiary of Exxon Corp.

Its fair market value was appraised at $53.63 million last July. At that appraised value, the contribution represents about 12% of the company's 1982 obligation. The appraised value also is slightly more than 1.5% of the fund's $3.530 billion in assets as of Sept. 30, 1982.

Exxon U.S.A. purchased the real estate for the appraised market value from Friendswood Development Co., another Exxon subsidiary. According to the Federal Reg-

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Fund still open to Seafirst bid

Washington board may take second look if B of A bid fails

By Steve Hemmerick

SEATTLE—The Washington State Investment Board might take a second look at acquiring ailing Seafirst Corp. if the corporation's 12,000 stockholders reject Bank of America's bid to acquire the Seattle bank holding company.

However, members of the investment board, who serve as trustees for $4.3 billion in state pension money, said last week they didn't have enough time or information on Seafirst to make a rival bid now.

John Hitchman, investment board director, said the board's consideration of buying Seafirst is a "harbinger of the future" and that "pension funds are going to be buying companies. It is something that is going to occur."

Bank of America has agreed to buy Seafirst, the trust department and other operations of the company's principal unit, Seattle First National Bank, for $250 million in cash and preferred stock, plus a $150 million capital infusion. Bank of America hopes to close the Seafirst transaction in 60 days. The Seafirst holding company announced a first-quarter net loss of $133 million, primarily a result of problems in the bank's energy-loan portfolio.

Seafirst's non-performing assets climbed to about $897 million at the end of the first quarter, from $800 million at the end of last year, according to Susan Chappel, who is an investor relations officer for Seafirst.

In commenting on Bank of

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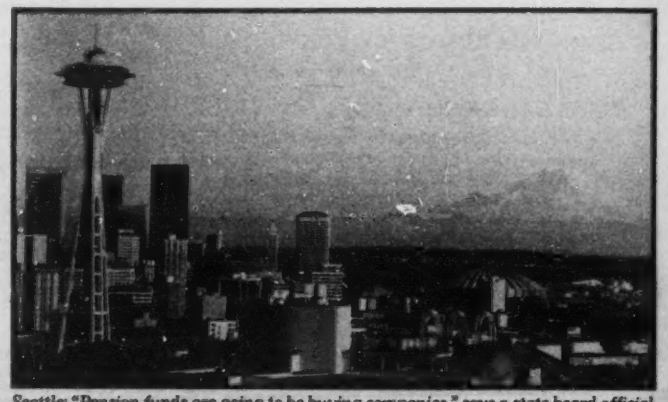

Seattle: "Pension funds are going to be buying companies," says a state board official

Continued from page 1
after several pension plans for which he is trustee purchased significant holdings in Cyclops stock (*Pensions & Investment Age*, May 2); further Cyclops stock purchase plans have been put in abeyance.

The government suit seeks to remove Mr. Simmons and other plan officials as trustees for allegedly violating their fiduciary duties under the Employee Retirement Income Security Act.

The agency also wants an independent asset manager appointed and the trustees ordered to repay any losses incurred by the plans.

The Labor Department suit, filed May 10 in federal court here, was combined with a separate suit filed April 29 by Jefferson Trust & Savings of Peoria, a trustee for the Keystone Master Deferred Incentive Trust. Keystone Consolidated Industries, Dallas, the plan sponsor, is controlled by Mr. Simmons. The bank suit seeks removal of the trustees for the plan.

Missouri fund hires

JEFFERSON CITY, Mo.—The $441 million Missouri State Employees Retirement System has decided to allocate 15% of its portfolio to real estate investments, Mary-Jean Hackwood, executive secretary announced. The Am Cal Co., North Hollywood, Calif., has been retained by the system as real estate adviser.

Assets go in-house

MORRIS PLAINS, N.J.—The Warner-Lambert Co. will begin to invest internally $30 million in equities for its $550 million pension fund this month, according to Joe Joshi, manager-pension investments.

The assets will come from cash flow and from three of its seven equity managers.

Alaska fund appoints

JUNEAU, Alaska—The Alaska Public Employees' Retirement System has hired Citibank and Morgan Guaranty Trust Co. as international managers to run portions of its $1.26 billion in combined pension assets, according to Milton Barker, deputy commissioner for treasury.

They will primarily manage foreign equities.

Firm sells property

ORLANDO, Fla.—Martin Marietta Corp., continuing its attempt to raise cash to reduce its debt, has sold a four-building office complex of a real estate subsidiary here to Aldrich, Eastman & Waltch for $25 million.

Aldrich, Eastman & Waltch purchased the property on behalf of a pension fund; a spokesman refused to identify the fund.

TIAA finances realty

ROCKVILLE, Md.--Teachers Insurance and Annuity Association is financing a $15.7 million, 323,500-square-foot industrial park development here through a participating mortgage.

The project will be the first phase of an 80-acre industrial park called Metro Park North.

The first 23 acres will consist of eight buildings for office and research and development space. The developer is Trammell Crow Co. and financing was arranged by a subsidiary of The Rouse Co.

Copperweld appoints

PITTSBURGH—Copperweld Corp. has hired Avatar Associates, New York, and Waddell & Reed Investment Advisers, Kansas City, Mo., to manage a portion of its $120 million pension fund, according to Bob Wohleber, assistant treasurer. The equity managers are funded out of new cash flow and will handle $10 million each.

Value Line a hot offer

NEW YORK—Eager investors quickly bought up an initial public offering of 1.9 million common shares of Value Line Inc., the investment advisory and publishing firm. The shares were offered May 10 at $17 each, but demand rocketed the price to a peak of $25 in over-the-counter trading, an almost 50% premium above the offering price.

The stock closed at $22.50. Lazard Freres & Co. managed the offering, which was valued at $32.3 million at the offering price. The shares constitute about 19% of the firm's total 10 million shares outstanding.

Value Line is owned by Arnold Bernhard & Co., whose voting stock is held by Arnold Bernhard, founder and chairman of Value Line. The investment advisory firm manages more than $1 billion in tax-exempt assets.

Lumi joins Bankers

NEW YORK—Rein Lumi, vice president in charge of corporate non-investment products at Chemical Bank, has joined Bankers Trust as vice president and director of the public funds and Taft-Hartley group. Mr. Lumi fills the spot vacated by Donal Murphy, who left the bank in April.

Also at Bankers, Seth Lynn, vice president and passive-management group head for the investment management group, has been named interim group sales/marketing manager. James Kieff, former vice president in charge of the marketing and administration division, left to join Batten, Barton, Durstine & Osborn International.

Byrne leaves GAF to start new firm

By Lynn Griffo

NEW YORK—Susan Byrne, formerly assistant treasurer of GAF Corp., has left the company to become president of Westwood Management Corp., a newly formed investment management firm for tax-exempt clients.

Westwood Management is a venture between Ms. Byrne and John Lakian, chairman of Fort Hill Investors, Boston, who is providing financial backing.

Because Ms. Byrne's investment style is completely different from that of Fort Hill, Mr. Lakian urged her to start a new firm.

Although he will not be involved in the day-to-day management of the company, Mr. Lakian is the chairman and chief executive officer of Westwood Management. Ms. Byrne said he will be providing business and support expertise.

Ms. Byrne, who left GAF in March, opened Westwood's doors April 1. The company has $50 million in assets under management, with GAF as its first client.

Asked why she left GAF, Ms. Byrne said, "Isn't it everyone's dream to work for yourself?"

Ms. Byrne spent four years at GAF, where she built a strong reputation as an excellent manager of pension assets.

GAF's board of directors and chief financial officer, James Sherwin, gave her free rein in single-handedly running the firm's pension assets, which total more than $200 million.

Her investment strategies brought excellent portfolio performance. Her expertise led GAF to recoup $35 million in overfunded assets when, in October 1982, it terminated its defined benefit plan for salaried employees in favor of a defined contribution, profit-sharing program.

GAF's salaried and hourly plans, both managed by Ms. Byrne, realized a 23.4% compound annual return between Dec. 31, 1978, and June 30, 1982, (*Pensions & Invest-*

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Susan Byrne: Leads advisory firm

Consistency marks first-quarter leaders

Top equity funds lassoed the bull

By Linda Savage Ruhe

CHICAGO—Investors who have ridden the bull market fully invested have also steered themselves into top performing positions.

Most of the funds recording the top equity returns for the quarter and year ending March 31 were fully invested when the market took off last August; in addition most purchased stock in similar sectors including consumer, technology, health care and financial.

Citizens Bank & Trust Co., Chillicothe, Mo., was the most consistent top performer in the past 10 years in the Pensions & Investments' Performance Evaluation Report compiled by Rogers, Casey & Barksdale.

For five and 10 years on an annualized basis, the fund ranked first with returns of 31.4% and 17.5%.; for the year, it ranked ninth with a 66% return, and for the quarter it ranked fifth with a 17.6% return.

According to Edgerton Welch, chairman of the board and trust officer at Citizens, these returns were achieved by selecting stocks based on the research the bank receives from Value Line, as well as the reports from the research departments at Blyth Eastman Paine Webber, Merrill Lynch, and E.F. Hutton.

Two industry sectors that played an important role in the portfolios recently were hospital management and brokerage, according to Ed Douglas, senior vice president and trust officer. Stocks in those areas that contributed to the portfolios included **Hospital Corp. of America, National Medical Enterprise, Paine Webber, Merrill Lynch, E.F. Hutton & Co. and American Express Co.**

Other industry sectors that have been contributors during the past 10 years included mining, energy, technology and airlines, according to Mr. Welch.

In general, the stocks the bank puts in its portfolios are from the

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Unique strategies pay off in bonds

By Lynn Griffo

DENVER—Zero coupons, perpetual preferred utilities and junk bonds were among the variety of strategies responsible for the high returns of the consistent top fixed-income performers.

In a strong showing of consistency, United Capital Management, the investment subsidiary of United Bank of Denver, was in the Pensions & Investments' Performance Evaluation Report top quartile for fixed-income funds for this year's first quarter, and for the one-, three-, five- and 10-year periods ending March 31. United Capital's strong first-quarter showing combined the foresight to purchase very long bonds with several unique bond strategies.

The bonds, purchased as early as 1981, included corporates, industrial utility and government bonds.

United began the first quarter of 1983 with 40% of its portfolio invested in long governments, and the remaining 60% in very long discount bonds, such as utilities and corporate original issue discount bonds.

The original issue discounts, with coupons ranging from 7% to 8.5%, were held in the portfolio throughout the first quarter of the year.

In addition, United Capital had put extra emphasis on Bbb rated utility bonds and original issue discount corporate bonds.

Both decisions paid off handsomely throughout the first quarter, according to William Cook, who is assistant vice president at United Capital.

The firm bought Bbb utility bonds throughout 1981 because they represented superior value in terms of yields and yield spreads, in addition to "looking cheap," Mr. Cook said.

In 1981, when interest rates were going "up and up," corporations were looking for ways to raise cash without being taken to the cleaners in the bond market. As a result, they began offering attractively

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